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IN THE

Supreme Court of the United States

October Term, 1965
No. .....

JERALD S. SCHUTZBANK, as Corporations Commissioner of the State of California,

Petitioner,

vs.

PETER M. ELLIOTT, as Trustee in Bankruptcy of the Estate of VAN'S MARKET, a copartnership composed of KENNETH M. PRICE and WILLIAM R. BABINEAU, Bankrupt,

Respondent.

REPLY TO PETITION FOR CERTIORARI.

Respondent respectfully offers the following considerations in response to the petitioner's Petition for Writ of Certiorari:

Statement of Facts.

Petitioner's Statement of Facts is erroneous in part in that it contains petitioner's conclusions such as "Van's held in trust funds received in the sale of Security money orders" and "it was obliged to hold in trust for Security the sum of $3,109.16."

The facts are accurately set forth in detail in the opinion of the Circuit Court of Appeals (*Elliott v. Bumb*, 356 F. 2d 749) on pages 750 and 751.

It is felt that it should be pointed out that *petitioner is in no way aggrieved by the ruling of the United States Court of Appeals for the Ninth Circuit.* As pointed out by the Court of Appeals (*Elliott v. Bumb,* 356 F. 2d 749) in footnote 3 on page 751 of that decision:

> "The Corporations Commissioner of the State of California asserts no claims to the funds held by appellant nor to the funds held by the Credit Managers Association, but as it is charged with the responsibility of enforcing the Check Sellers and Cashers Law, Cal. Fin. Code §§ 12000 et. seq., it is thus concerned with the interpretation placed upon said law by this Court".

If this Honorable Court were to grant petitioner's Petition, as he requests, the only party who would stand to gain thereby would be the appellee below, A. J. Bumb, *who is not before this Court.*

It is therefore respectfully submitted that petitioner is not the proper party to seek a Writ of Ceriorari.

Petitioner's Alleged Reasons for Granting the Writ.

It is respectfully submitted that petitioner has failed to state any grounds for granting its petition under Rule 19 of the Rules of this Honorable Court. It is submitted that the Ninth Circuit Decision is not in conflict with any other Court of Appeals but on the contrary is in accord with other circuits and with the decisions of this Honorable Court and is not in conflict with any state or territorial law. It is obvious that no other Court of Appeals could decide the exact question as decided by the Ninth Circuit, as it was confronted

with a California statute which was struck down as being in conflict with the Federal Bankruptcy Law. However, respondent will endeavor to answer each specific point raised by petitioner in his petition.

Petitioner claims "there is nothing in the Bankruptcy Law which generally requires that there be a specific tracing before a trust beneficiary can be made whole". This is not a true statement of what, it is submitted, is a well settled principle of bankruptcy law.

As stated by the author in Vol. 4 Collier on Bankruptcy §70.25(2), at pages 1216-18:

> "The basic idea of the trust doctrine as applied in bankruptcy is a fair and reasonable identification of the property or fund so as not to harm other creditors. It is not enough, therefore, to show merely that the funds or property came into the bankrupt's hands or went into the bankrupt's business or, by the better view, even that the funds or property are contained somewhere within the bankrupt's estate. If the trust fund or property cannot be identified in its original or substituted form, the cestui becomes merely a general creditor of the estate, for the prevailing rule in trusts is that 'a beneficiary who cannot find the trust property has no lien or charge spread over the entire estate of the faithless trustee' ".

Even the Internal Revenue Code, which provides for a trust in favor of the United States for withholding taxes does not dispense with the requirement that the beneficiary trace the trust property into specific property in the hands of a trustee in bankruptcy.

Title 26 United States Code, Section 7501(a) provides:

> "Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose".

In the case of *Hercules Service Parts Corp. v. United States* (6th Cir., 1953), 202 F. 2d 398, the Court said, in discussing Section 7501(a) (Section 3661 under the 1939 Code):

> "It is the general rule that *a trust cannot be impressed* for the benefit of the cestui que trust *unless the trust property is identified or the corpus of the trust is traced into some specific fund* or thing into which the original trust property has passed in some form. The Congress in Section 3661, when it provided in effect that any person required to collect or withhold any internal revenue taxes is a trustee for the amount of such taxes, did not dispense with the test for the recovery of diverted trust funds. Here the diverted trust funds are not identified and no evidence exists that the assets of the debtor were augmented by the payments". (Emphasis added).

Section 64 of the Bankruptcy Act was amended by Congress in 1938 to do away with all state created priorities save one, rent owing a landlord.

As stated in Vol. 3 Collier on Bankruptcy §64.01 at page 2053:

> "The most extensive change in Section 64 occurred in what under the 1938 Act is the fifth and last class of prior claims—Under this clause persons entitled to priorities under state laws are no longer entitled to prior claims in bankruptcy, except in case of rent; under the corresponding clause of the 1898 Act they were. The change was made in view of supernumerous additions to priority by state legislation, often in conflict with the policy of the Bankruptcy Act".

Collier goes on to say in footnote 27 on pages 2053 and 2054:

> "Regarding this change, it was said in the Analysis of H. R. 12889, 74th Cong., 2d Sess. (1936) 201: 'We have deleted all state priorities except in the case of a landlord—'for like reasons of policy, we have excluded, as indicated, all other state priorities. The necessity for so doing is obvious; many estates have been consumed, to the exclusion of creditors, by the ever-increasing classes of state priorities' ".

The Court of Appeals below accurately appraised the situation by holding on page 755 of that decision (*Elliott v. Bumb, supra*):

> "Giving effect to the provisions of section 12300.-3, which would impress a trust upon commingled funds, would open the door to state creation of priorities in favor of various classes of creditors by labeling such priorities as 'trusts'. This would tend to thwart or obstruct the scheme of federal bank-

ruptcy. It may be true that Congress was aware of statutory trusts when it made its most recent amendments to the bankruptcy law, for courts were previously confronted with state statutory trusts in bankruptcy cases. *E.g., In re Treister & Son, Inc.*, 145 F. Supp. 144 (S.D.N.Y. 1956); *Albert Pick Co. v. Travis*, 6 F. Supp. 486 (E.D.N.Y. 1933). We cannot believe, however, that Congress contemplated that if trust funds are commingled with other assets of one subsequently declared bankrupt under federal law, a state statute may impress a trust on all assets of the bankrupt's estate to the extent of the amount due the beneficiary. We find no prior case authority whoch would have adequately warned Congress of the possibility of such a result, and we have pointed to direct authority for the opposite conclusion".

Conclusion.

Petitioner, in his conclusion, states that the California Financial Codes in question were designed to preserve the integrity of trust funds rather than to give the check seller and casher priority in the general assets of the agent.

It is submitted that to give credence to petitioner's position could only result in giving priority in the general assets of the agent. He would have the so-called "trust" imposed upon the agent's stock in trade, fixtures or other assets which have no relation whatsoever to the original proceeds from the sale of money orders and checks. As stated by the California Supreme

Court in the case of *Bank of America v. Bowden,* 46 Cal. 2d 863:

> "One of the purposes of the legislature in enacting certain provisions of that law which are here involved was to safeguard from the general creditors of the licensed check seller—the funds paid."

For the foregoing reasons, it is respectfully submitted that the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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